United States General Accounting Office

GAO

Briefing Report to the Honorable Helen Delich Bentley, House of Representatives

15

September 1988

# AIR FORCE PROCUREMENT

# Ammunition Container Contract

GAO/NSIAD-88-218BR

GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-227061.4

September 1, 1988

The Honorable Helen Delich Bentley
House of Representatives

Dear Mrs. Bentley:

Your February 5, 1988, letter raised a number of questions about the U.S. Air Force's procurement of steel ammunition storage containers for which the contractor, Interpool Limited, located in New York City, obtained most of the labor and materials from a West German subcontractor and its Polish licensee. On July 13, 1988, we briefed your staff on the results of our work. Responses to your specific questions and concerns are provided in appendix I of this report.

In summary, we found that (1) there were no significant problems involving the solicitation, award or administration of the 1986 or 1987 container contracts, (2) no law or regulation precludes awarding such contracts or subcontracts to firms located in Poland or any other member of the Warsaw Pact, (3) there have been no significant quality problems with the 360 containers delivered under the 1986 contract, (4) the first 800 of the 1,640 containers to be ordered under the 1987 contract are not due for delivery until September 1988, and (5) the Air Force does not now plan to award a 1988 contract for this type of ammunition container.

The Air Force discovered that in 1986 the contractor failed to follow contract and statutory requirements to use only U.S. flag vessels for the ocean transportation of containers delivered under this contract. To correct this omission, the Air Force's contracting officer recently negotiated an equitable adjustment of about $10,000 paid by the contractor. The Maritime Administration (MARAD) has reviewed this adjustment and considers it to have resolved the improper shipment of 21 containers. However, MARAD is still looking into the shipment of 55 other containers on foreign flag vessels to determine if another adjustment is needed.

To obtain information necessary to respond to your questions, we interviewed officials of the Department of Defense, the Air Force, MARAD, and Interpool Limited. We also reviewed applicable laws, regulations, correspondence, and documents concerning the solicitation, award, and administration of the 1986 and 1987 container contracts. Our work was conducted from February through June 1988, in the Washington, D.C.,

area and was performed in accordance with generally accepted government auditing standards.

As agreed with your office, we did not obtain official agency comments on this report. However, we discussed it with the officials involved and incorporated their comments as appropriate. We are sending copies of this report to the Secretaries of Defense and Air Force, MARAD's Office of Market Development, Interpool Limited and to other interested parties on request.

If we can be of further assistance, please call me on 275-4812.

Sincerely yours,

Allan I. Mendelowitz
Senior Associate Director

BLANK PAGE

# Contents


Letter 1

Appendix I Responses to Specific Questions and Concerns 6

Table

Table 1.1: Labor and Material Breakdown for the USAF's 1986 and 1987 Container Contracts 11


**Abbreviations**

| | |
|---|---|
| DOD | Department of Defense |
| FAR | Federal Acquisition Regulation |
| GAO | General Accounting Office |
| MARAD | Maritime Administration |
| USAF | United States Air Force |

# Responses to Specific Questions and Concerns

1. List all bidders and their price quotes for the 1986 and 1987 USAF award for these containers.

Both years' contracts were negotiated competitive awards, and all offerors proposed manufacturing the containers outside the United States. There were 8 responsive offers to the U.S. Air Force's (USAF's) 1986 solicitation for side-loading steel ammunition storage and transportation containers. On June 4, 1986, the contract (number F61546-86-D-0016) was awarded to Interpool Limited for $915,000, which was about 6 percent less than the next lowest offer for the initial quantity of containers. The award was for an initial quantity of 300 containers with an option to purchase 60 additional containers. The offers were evaluated based on the prices submitted for both the initial and the optional quantities. The 60 additional containers covered by the option were purchased under this contract. Interpool's total offer for all containers was $1,067,500. The other offers for the contract were, Leelco Agencies ($1,141,350), W.H. Davis ($1,277,531), Yorkshire Marine Containers Limited ($1,317,305), Inter-Continental Equipment Incorporated ($1,493,500), Thyssen Industries AG ($1,885,243), Transtac Management Corporation ($1,892,250), and SFC Daval ($2,079,608).

There were 7 responsive offers to the 1987 solicitation. On September 16, 1987, the contract (number F61546-87-D-0023) was awarded for 1,640 containers, including a basic quantity of 800 and an additional optional quantity of 840, to Interpool Limited for $4,325,000, which was about 10 percent less than the next lowest offer. The other offers for this contract were Inter-Continental Equipment Incorporated ($4,798,500), Jeffery Corporation of Netzer Sereni Metal Works ($5,810,700), Leelco Agencies ($5,250,000), Morteo Soprefin SPA ($6,150,485), Adamson Modular Systems Limited ($6,600,000), and Yorkshire Marine Containers Limited ($8,33 .,900).

2. Did the USAF have Pentagon permission to purchase these units?

The Department of Defense (DOD) and the USAF state that there is no requirement that DOD approve USAF purchases of containers provided by Warsaw Pact countries, such as Poland.[1] Therefore the USAF neither sought nor received DOD permission to award the 1986 or 1987 container contracts.

[1]Warsaw Pact countries include the Soviet Union, Poland, Rumania, East Germany, Hungary, Czechoslovakia, and Bulgaria.

3. What other U.S. DOD/USAF contracts have been awarded to Warsaw Pact countries in the last five years?

Only one prime contract has been awarded to a contractor from a Warsaw Pact country since fiscal year 1983. In 1986, a contractor from Hungary was awarded a $39,000 contract for chemicals. The only automated information available on subcontracting begins with fiscal year 1986 and shows no awards to subcontractors from these countries.

4. What makes a defense production item "militarily sensitive?" Does the fact that these containers will hold millions of dollars of weapons and can contain bugging or self-destruct systems not bother the USAF?

The DOD Dictionary of Military and Associated Terms (June 1, 1987) defines sensitive as "requiring special protection from disclosure which could cause embarrassment, compromise, or threat to the security of the sponsoring power." In responding to a prior question about ammunition storage containers, the USAF used the term "militarily sensitive" in the context of an item, the disclosure of which could cause compromise or threat to the national security. It is the USAF's opinion that ammunition storage containers are not such a militarily sensitive item.

Security directives require that all items received by the USAF be inspected prior to acceptance. Also, all items entering munitions storage areas must be checked for clandestine devices, which include bugging or self-destruct devices. The same inspections are required for similar items purchased from any foreign country. All of the 360 containers delivered under the 1986 contract have been inspected, and no devices of any kind were found in or on them.

5. What USAF command in Washington, D.C., had jurisdiction over this purchase? Obtain copies of all relevant message traffic on this issue.

There is no direct line responsibility for these purchases at the USAF's headquarters in Washington, D.C. The Headquarters, USAF/Europe has direct responsibility over the West German based contracting center's purchase of the ammunition containers under both the 1986 and 1987 contracts.

Correspondence between the contracting center and higher level USAF officials in West Germany and the United States dealt primarily with the (1) unsuccessful bid protests on both the 1986 and 1987 contract

awards, (2) decision to award both contracts in U.S. dollars, and (3) resolution of a cargo preference problem on the 1986 contract.

6. Once the 1986 award was made to Poland, what USAF or other U.S. government personnel went to Poland to supervise, inspect and arrange for transport of the containers?

No USAF or other U.S. government personnel went to Poland on pre- or post-award visits to supervise, inspect, or arrange transport of the containers built there. However, under the terms of the contracts, all containers must be certified by one of three organizations (Lloyds Registry of Shipping, the American Bureau of Shipping, or Bureau Veritas) as meeting all the national and international container construction requirements of six certifying organizations, including the International Standards Organization and the American National Standards Institute. Accordingly, personnel from the American Bureau of Shipping went to Poland and West Germany in 1986 and will go again in 1988 to inspect all containers during manufacture and to certify that they meet the various requirements for such containers.

In addition, USAF officials inspected all containers from the 1986 contract at various points in transit and again at the final delivery points. Similar inspections are planned for the containers delivered under the 1987 contract.

7. Verify if the USAF had adopted prior to its decision on this contract an internal budgetary policy (without need of statutes or regulations in the Code of Federal Regulations) prohibiting the purchase of typewriters from Warsaw Pact countries.

The USAF did not unilaterally adopt or establish any internal policy (without basis in law or regulation) which prohibited the purchase of typewriters or any other commodities from contractors in Warsaw Pact countries. The prohibition in question (concerning manual typewriters made in Warsaw Pact countries) was first incorporated as section 780 in the Fiscal Year 1983 Defense Appropriations Act. It has since been incorporated into the DOD Supplement to the Federal Acquisition Regulation (FAR) as section 25.7004 (48 U.S.C. 225.7004).

Since 1974, pursuant to an agreement among DOD and the Departments of Commerce, Treasury, and State, DOD policy has been to permit awards to contractors from Warsaw Pact countries. The contractors from these countries are treated the same as those from any other foreign countries

in evaluating their bids for the commodities not otherwise affected by legislative prohibitions (for example, the prohibition against buying manual typewriters from Warsaw Pact countries). However, for national security reasons, contractors from Warsaw Pact countries would not be eligible for most DOD contracts.

8. How many containers built in 1986 have had leaking or floor problems for the USAF? Provide a list of where these containers are now and what is the 1987 contract production schedule.

A total of 360 containers were bought under the 1986 contract. All have been delivered, and no leaking or floor problems have been experienced. However, the USAF informed us that these types of problems were common to another type of container built by another company under an earlier contract.

A minor problem was found when the contractor failed to meet specifications for the strength of lashing rings. The USAF has estimated the cost to resolve this problem at about $5,000 and is negotiating an adjustment to be paid by the contractor.

As of March 1988, the containers bought under the 1986 contract were located as follows: 300 in Norway, 21 in the United Kingdom, 12 in West Germany, 12 with the Army in an unspecified location, 7 in Italy, 6 in the United States, and 2 in Greece.

A total purchase of 1,640 containers under the 1987 contract is planned. The first 800 are due for delivery in September 1988 to the following locations: 377 to the United Kingdom, 231 to West Germany, 70 to Spain, 61 to Denmark, 46 to Italy, and 15 to the Netherlands. The remaining 840 containers are to be delivered to West Germany.

9. Does the USAF intend to purchase more of these units this year?

At this time, the USAF is not planning to award a 1988 contract for this type of side-loading steel ammunition storage and transportation container.

10. Provide detailed information on the company (Interpool) that won the award. Where are they incorporated; who are the officers; have they built any other U.S. government contracts in Warsaw Pact nations? Provide information on the Polish plant where the containers were built (government subsidy, Soviet work record, etc.).

According to company officials, Interpool Limited, established in 1968, is located in New York City but is incorporated in the Bahamas. Its top management includes Mr. M. Tuchman (chairman and chief executive officer), Mr. R. Witteveen (president), Mr. R. Guarini (treasurer and comptroller), and Mr. A. Burns (secretary and general counsel). On the two USAF container contracts, Interpool subcontracted the work to Containertechnik Hamberg Gmbh and Company in West Germany (Mr. E. Schmidt, president), which in turn licensed some of the work to a factory in Szczecin, Poland. Interpool informed the USAF that it has had no other contracts to construct containers for U.S. government agencies over the past 5 years.

Interpool Limited is a wholly owned subsidiary of WMR 1 Leasing Corporation of Delaware. WMR's officers include Mr. M. Tuchman (president), Mr. R. Witteveen (secretary and treasurer), and Mr. T. Birnie (vice president). These corporations lease storage and transportation containers and chassis.

11. After award of the 1986 Polish award the USAF said that most components of the units were from West Germany. Verify this and give a breakdown of material and labor provided by Interpool in West Germany.

The labor and material breakdown for the 1986 and 1987 container contracts shows that most of the work was done in West Germany and Poland, with a small percentage performed in the United States, Italy, and Austria. See table 1.1.

**Table 1.1:Labor and Material Breakdown for the USAF's 1986 and 1987 Container Contracts**

Figures in percent

| | Labor and materials |
|---|---|
| **1986** | |
| West Germany | 50 4 |
| Poland | 41 5 |
| Other countries | 8 1 |
| **1987** | |
| Basic 800 | |
| West Germany | 29 9 |
| Poland | 33 2 |
| Other countries | 26 9 |
| Additional 840 | |
| West Germany | 43 5 |
| Poland | 36 3 |
| Other countries | 20 2 |

12. Did Interpool receive any cost overruns it applied for in the 1986 award?

Interpool neither applied for nor received reimbursement for any cost overruns on the 1986 contract. The six modifications made to this contract included reductions in cost due to the contractor's failure to transport containers on U.S. flag vessels and a minor problem with the specifications for lashing ring strength, which has been corrected. Other modifications dealt primarily with changing delivery dates and the number of containers to be delivered to various locations.

No applications for or payments of cost overruns have been made on the 1987 contract. The two modifications to this contract involved minor changes to several clauses and a small reduction in the contract price.

13. Since this controversy has begun, has the GAO or the USAF discussed means of contract administration that would preclude Warsaw Pact participation (as Korea, etc. can be excluded) on future tenders?

Such prohibitions generally would be a matter of national policy rather than a contract administration issue. The USAF is considering a proposed procedure which would require all potential awards to contractors and subcontractors from Warsaw Pact countries to be approved in advance by the Assistant Secretary for Acquisitions. We have not addressed the issue of procurement from Warsaw Pact countries in any recent studies.

14. How can cargo preference administration procedures properly apply in the pre-award process for this type of contract?

FAR clause 52.247.64 requires that all non-construction contracts ship at least half of all ocean cargo on U.S. flag vessels. When using Alternative I of the clause, which reflects 10 U.S.C. 2631, the cargo preference requirement for all non-construction contracts increases to 100 percent. The preference must be followed unless U.S. flag vessels are not available at a fair and reasonable price and is supposed to be part of all USAF non-construction contracts. The clause also requires that the contractor provide evidence that the preference for U.S. vessels has been followed.

Before making an award, the USAF states that it emphasizes the cargo preference requirement and refers bidders to MARAD for determinations of U.S. flag vessels' availability and the reasonableness of proposed transportation rates. A bidder can offer transportation prices based on ocean shipment by foreign flag vessels only if MARAD has made a negative determination concerning availability or rates.

In the 1986 container contract, the USAF made a mistake by including only the clause requiring a 50 rather than the 100-percent U.S. flag cargo preference requirement. The contractor's records show that only foreign flag vessels were used for all ocean transportation of containers under this contract. When this situation was later discovered, the USAF modified the contract to incorporate the proper 100-percent requirement and negotiated an equitable adjustment (about $10,000) for the improper shipment of 21 containers. The adjustment required the contractor to pay the difference between the transportation costs of the foreign flag vessels used and those which would have been paid by using U.S. flag vessels. MARAD has reviewed the adjustment made for the 21 containers and agrees that it was properly done. However, MARAD is now looking at the shipment of 55 other containers to determine if another adjustment is required.

Until recently, DOD maintained that FOB-destination[2] cargo was not owned by DOD until it was delivered, and therefore it was not subject to cargo preference requirements. MARAD officials told us that they disagreed, based on the Comptroller General's opinion of May 5, 1936, which held that all purchases made for DOD were subject to the cargo preference laws. On February 2, 1988, the Department of Justice issued

[2]Free on board: without charge to the buyer for placing goods on board a carrier at the point of shipment. FOB-destination cargo is the shipper's responsibility until it arrives at its destination.

a memorandum which also concluded that cargo preference laws apply to all purchases for DOD regardless of who has title at the time of shipment.

The USAF's investigation of the cargo preference actions required by and taken on its 1986 and 1987 container contracts has indicated that the FAR and the DOD and USAF supplements to it are neither consistent nor clear as to how decisions are to be made on how to apply the law and who is responsible for resolving cargo preference problems. Currently, a DOD task force is developing proposed changes for the FAR and its supplements, to clarify the instructions and responsibilities and to accommodate the recent Justice Department decision.

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.